

Is Your Non-Compete Valid Under Pennsylvania Law?

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Employers engaged in enterprises that involve trade secrets and confidential or proprietary business information are increasingly entering into agreements with employees that include confidentiality provisions, covenants not to compete, and covenants not to solicit. But in these difficult economic times, when employees are involuntarily separated from their employers in a reduction in force or downsizing, is that non-competition agreement enforceable?

As a general matter, restrictive covenants are considered a restraint of trade and are looked upon unfavorably. In Pennsylvania, there is no statute that specifically addresses restrictive covenants; rather, courts look to the reasonableness of the restrictions and traditional contract law principles in deciding whether a non-compete and non-solicit agreement is valid and enforceable. Increasingly, the circumstances surrounding the employee's separation or termination from employment are also a factor that must be considered to determine if the non-compete restriction should be enforced.

Take for example the Pennsylvania Superior Court's decision in *Insulation Corporation of America v. Brobston*. Brobston, a ten-year salesperson, was privy to certain confidential corporate information such as overhead costs, profit margin, dealer discounts, customer pricing, marketing strategy and customer contract terms of his employer. Information of this nature was a business interest able to be protected under the "non-disclosure" covenant of the employment contract. Brobston was terminated because he failed to increase the company's sales. Among the reasons cited, Brobston was terminated for failing to take overnight sales trips to develop business and for failing to report sales calls and expenses. In short, he was fired for "failing to promote his employer's interests." Despite his poor sales performance, the company still sought to enforce a two-year, 300 mile non-compete agreement to keep him from working for a competitor. The Superior Court reversed the trial court's injunction against Brobston's competing with the company, stating that the "salesman, discharged for poor sales performance, cannot reasonably be perceived to pose the same competitive threat to his employer's business interests as the salesman whose performance is not questioned, but who voluntarily resigns to join another business in direct competition with the employer."

Since *Brobston*, Pennsylvania courts have suggested that employees who leave their employers through no fault of their own may also escape the restrictions of their non-compete agreements. In *All-Pak, Inc. v. Johnston*, the Superior Court was sympathetic to employees terminated for reasons beyond their control, perhaps opening the door for employees affected by downsizing or layoffs to claim that their non-compete agreements should not be enforced. However, there is an equally compelling argument that in these challenging economic times, employers' legitimate business interests are even more in need of protection from competition than ever.

Although this issue is far from clear, two trends emerge from these cases. First, companies that terminate an employee's employment for poor performance relative to the company's legitimate business interests cannot turn around and prevent that former employee from competing with them. Second, an employee terminated for misconduct or disloyalty will not be able to avoid his obligations under a non-compete. Despite these recent trends, the following are still valid guiding principles when drafting restrictive covenants in Pennsylvania.

1. Covenants not to compete are enforced to the extent reasonably necessary to protect the legitimate business interests of the employer -- the employer's relationship with its customers, confidential information, good will, and trade secrets. The information must belong to the employer and be developed through the efforts of the employer -- information that is common knowledge or can be derived from a phone book or directory is not a protectable interest.
2. Pennsylvania courts will permit the equitable enforcement of post-employment restraints only where they are incident to an employment relation between the parties, the restrictions are reasonably necessary for the protection of the employer, and the restrictions are reasonably limited in duration and geographic scope.
3. The signing of a covenant at the inception, or within a few days after the inception, of the employment relationship is sufficient consideration to support the covenant. Note that a non-compete or non-solicit entered into mid-stream -- in the course of an employment relationship -- must be accompanied by sufficient additional consideration to be valid and enforceable. Generally, a "beneficial change in an employee's status" is sufficient consideration. Continued employment, however, will not provide sufficient consideration.
4. The length of time and geographic area should be no greater than is reasonably necessary to protect the employer's legitimate business interests. As a general matter, Pennsylvania courts and federal courts have consistently affirmed covenants with temporal restrictions of one to three years and, depending on the nature of the business, a nationwide geographic scope may be appropriate. The more reasoned approach, however, is to limit the geographic scope to the territory where the particular employee engaged in business for the company.
5. If the restrictions of the covenant are overbroad, the courts are permitted to "blue-pencil" the covenant to make the restrictions more narrow and to make the covenant enforceable.

Barley Snyder's Employment Law attorneys can assist companies of all sizes across a variety of industries in preparing non-compete agreements that protect their business interests. On November 17, 2009, Jill Welch will provide tips to employers to help protect their competitive edge through the enforcement of non-compete and non-solicit agreements at Barley Snyder's fall seminar "Managing Your Business In Challenging Times." The seminar will be held at the Berkshire Country Club in Reading from 7:30 a.m. to 12:00 noon. Information on additional seminars in your area can be found in this newsletter or on Barley Snyder's website at www.barley.com/seminars.

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